Information Note

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Ofgem refuses Scottish Power Energy Networks request to relax its distribution losses targets

Energy regulator Ofgem has today declined a request by Scottish Power Energy Networks to relax targets for reducing losses from its electricity distribution networks in Southern Scotland, Merseyside and North Wales.

Ofgem has however decided to allow Scottish Power an increase in its losses target for electricity transmitted at extra-high voltages to some large industrial customers in southern Scotland.

The net effect of Ofgem's decisions is that the company will not be able to recover £49.4 million in additional revenues for the first four years of the 2005-2010 electricity distribution price control. Scottish Power would have gained this additional revenue through increasing distribution charges. The company is likely to incur a further penalty adjustment in the last year of the price control.

Scottish Power sought an increase in its targets for reducing losses under the regulatory rules for the price control. Ofgem's governing board – the Gas and Electricity Markets Authority examined this request in detail and has decided not to allow the increase. This is because Scottish Power has not demonstrated a material change in the quality of information available on the units entering and exiting its networks, which would warrant a change to its allowed loss percentages under its existing five year price control.

In 2006, Scottish Power agreed to a tougher target on distribution losses under a compromise agreement following an investigation by Ofgem into its compliance with reporting requirements for losses. In 2007 Scottish Power wrote to Ofgem asking the regulator to relax the target during the current distribution price control (2005-2010) due to the financial penalties it was incurring from missing the revised targets. This triggered a review of the request and a decision has now been made by Ofgem's Authority.

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Notes to Editors:

1. How does the distribution losses incentive scheme work?

It is inevitable that some electricity will be lost as heat the further it has to travel through the distribution network. Some electricity is also 'lost' due to theft and through administrative errors. Under the 2005-2010 price control, all electricity distribution network owners (DNOs) have targets set by Ofgem for reducing these losses. The targets are expressed in percentages of the total amount of units distributed by each electricity distribution network operator (these are known as allowed loss percentages or ALPs). If DNOs outperform the targets they can earn additional revenue. If they miss the targets they are penalised. These incentives encourage DNOs to tackle the carbon footprint associated with electricity distribution.

2. Increase in the allowed loss percentages relating to electricity transmitted at extra high voltages to some industrial sites in southern Scotland

When Scottish Power asked for an increase in the overall allowed loss percentages (ALPs) for its two distribution networks it also asked Ofgem to apply an increase to its ALPs in relation to electricity transmitted at extra-high voltages (EHV) to some large industrial customers in southern Scotland. This was to correct for the fact that the sites concerned were included in the original ALP calculations for the 2005-2010 price control whereas they ought to have been omitted.

Before the introduction of the British Electricity Trading and Transmission Arrangements (BETTA) in 2005, the industrial sites referred to were deemed to receive their electricity from the local distribution network. However, since the introduction of BETTA they have been deemed to receive their supply from the transmission network. (In Scotland, Scottish and Southern Energy and Scottish Power own the transmission and distribution networks in northern and southern Scotland respectively)

Because the large industrial customers concerned are situated very close to the transmission/distribution system interface they have very low levels of distribution losses associated with them which tended to reduce overall loss percentages slightly prior to the introduction of BETTA. Therefore, they ought to have been excluded from the original ALP calculations for Scottish Power's distribution network to allow for performance to be measured on the same basis as the one on which the overall ALP targets were set. Ofgem has therefore allowed an increase in the ALP for Scottish Power's southern Scotland distribution network.

3. Ofgem's decision on ALPs:

If Ofgem had disallowed Scottish Power's representation in relation to the relevant EHV sites, the total amount of revenue it would have to have forgone for the first four years of the 2005-2010 price control would have been £58.8 million. Ofgem's decision to allow the representation under the EHV units reduces this to £49.4 million. Had Ofgem permitted an increase in Scottish Power's overall ALPs, this would have allowed it to increase electricity distribution charges for suppliers and ultimately customers in the areas served by its distribution networks. The £49.4 million is therefore revenue that Scottish Power has foregone by not being able to increase its distribution charges. In reaching its decision the Authority also considered the wider impacts of increasing Scottish Power's targets - which would involve a significant adverse impact in terms of cost on suppliers and consumers in the affected areas. Full details of the Authority's decision can be found in the decision letter which has also been published on Ofgem's website.

4. Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Act 2004, the Energy Act 2008 as well as arising from directly effective European Community legislation.

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